INFORMATION 21

PROVIDING EQUITABLE TREATMENT FOR LARGE AND SMALL MEMBERS

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The Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies, confers and advises with officials of farmer cooperatives, and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

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Is it possible to charge all cooperative members alike for goods or a service--and still be unfair to some of them? Results of a recent survey reveal widespread belief that it is possible.

In the early days of American cooperatives, when virtually all farmers were producing on a small scale, the possibility of equal per-unit treatment being unfair did not exist. But as some farmers have increased the scope of their operations manyfold while others have been content to continue with a small-scale operation, the disparity between the largest cooperative member and the smallest cooperative member has grown and continues to grow.

Belief in Equality Widely Held

Growing disparity notwithstanding, extensive correspondence and conversations with cooperative leaders reveal a widely-held conviction that equal treatment is somehow an essential characteristic of cooperative endeavor. One group notes simply that equal per-unit charges or margins are desirable. A second group believes that such equality is one of the basic cooperative principles. The third group is convinced that strict equality is actually mandatory in order to preserve cooperative status under State and Federal laws.

It is generally agreed that cooperatives have a strong idealistic element.

One result of this idealism has been repeated effort over the years to draw up what might be called Articles of Faith.

An example of such an attempt occurred in the 1930's. The International Cooperative Alliance, at its 1930 meeting, instructed a committee to search out and list the basic principles guiding European consumer cooperatives. The committee traveled widely, and 4 years later reported the following seven most commonly accepted principles:

1. Open membership.
2. Democratic control.
3. Dividends on purchases.
4. Limited interest on capital.
5. Political and religious neutrality.
6. Cash trading.
7. Promotion of education.

This list is often referred to as the Rochdale Principles.

Here in the United States at about the same time, a leading midwest cooperative developed and promulgated its own list of principles. They resemble closely the preceding list:

1. Open membership.
2. One member--one vote.
3. Limited interest on shares.
4. Patronage refund on purchases.
5. Sell for cash at market prices.
6. Neutrality in race, religion, and politics.
7. Educate constantly.
8. Expand continuously.

Still more recently Farmer Cooperative Service, in a publication entitled "Three Principles of Agricultural Cooperation,"[1] discussed three fundamental principles which set cooperatives apart from other forms of business endeavor. These principles are:

1. Democratic control.
2. Limited return on capital.
3. Sharing savings in proportion to patronage.

It is highly significant that none of these lists says anything about equal treatment, equal handling charges, or equal operating margins.

Still, since so many people adhere to the belief that cooperatives and equal treatment are somehow inseparable, it is interesting to review some comments on the subject. First, here are views from several who consider that equal treatment for all is highly desirable, but probably

[1] Fetrow, Ward W.; Gardner, Kelsey B.; and Heckman, John H. Three Principles of Agricultural Cooperation. Educational Circular 13, Farmer Cooperative Service, U.S. Dept. of Agr. Nov. 1958.

difficult to apply under current cooperative conditions.

These Believe Equality Desirable

"For years," stresses one association manager, "we have felt that equal treatment of all members of a cooperative has been absolutely necessary. However, in view of today's changing agriculture, equal treatment no longer means equal per-unit pricing."

Here is what another cooperative leader has to say about the same subject: "The trend seems to be that larger users of products should at least share in the lower per-unit cost of handling these products. The argument that this is unfair to the small-volume patrons might be answered that if it were not for the larger-volume patron, the cooperative could not be competitive in its market area, and thus would lose large-volume patrons. This would increase the cost to the small-volume patrons. If there were not enough of them, it could

Some cooperatives charge everyone the same price.

result in the collapse of the cooperative--at which point no one benefits.

"I personally tend to favor the 'one price for everyone' theory on the local cooperative level. However, I know to advocate it borders on wishful thinking, because it appears to be neither practical nor possible in this day."

Still another writer makes this comment: "It is my opinion that every effort should be made to give fair treatment to all patrons. If it can be established that a large-volume purchase can be made for a lower per-unit handling cost, this should be taken into consideration when pricing the product. At the same time, great care should be exercised not to penalize the small patron, nor can unfair advantage be given to the large one."

These Believe Equality Basic

Now turn attention to some reflections of those who feel very strongly that equal treatment is not only desirable but is a basic cooperative principle.

"Relative to the problem of equal treatment versus fair treatment of patrons," says one, "it has been my contention that cooperatives must never lose sight of the fact that equality (per unit) must prevail at all times. The very foundations upon which cooperatives were built rests on equal treatment of all members and patrons. I do not believe we should complicate our machinery by such policies as adjusting charges with actual costs, or other devices such as a sliding scale of per-unit prices."

Another writer sums it up more succinctly: "Historically, basic cooperative philosophy says that all patrons should be treated alike."

Some Even Believe Equality Mandatory

There are even a few cooperatives whose leaders believe (mistakenly) that equal per-unit charges and margins are mandatory under law. An example of this is a vegetable marketing cooperative which sought help a number of years ago. The organization was losing large sums of money by providing pickup and delivery service at a fixed per-unit cost regardless of distance traveled or volume handled. The manager was quite skeptical when told it would be perfectly proper to charge members what it

actually cost the association to provide the services.

So it is apparent that in the minds of many people the concept of equal treatment, sans modifying phrases or clauses, is a part of the cooperative image. Just why should this be?

A search for the answer to the question leads to the conclusion that the feeling is probably due to the widely accepted one member-one vote, democratic control concept.

"Working for my father in the cooperative I learned the principle of 'one price to all.' Such a policy seemed to coincide with the cooperative principle of one man-one vote." This is how one man summed it up.

In the light of the previous discussion, let's restate the opening question and add another one as follows:

1. Is it possible that equal treatment may not always be fair?

2. Is there another kind of equality, not measured in charges or margins?

In answer to the first question, the manager of an extremely successful marketing association has this to say: "It has been the belief in our association for some years that equal treatment of members has been outmoded by wide differences in volumes which have resulted from the trend to larger farming units. Equal treatment was an applicable principle when all users of the cooperative services were approximately the same size. Under these conditions, equal and fair treatment became synonymous. However, as individual growers became large enough to effect material savings through the size of their purchases or marketings, then fair treatment became another matter."

The same writer has a very effective answer to the second question posed above: "In dealing with these problems," he says, "our association has taken the view that all members are treated equally when asked to share their fair proportion of association costs. Consequently, (our) pricing structures reflect savings for volume <u>where such savings can be supported on an actual cost basis.</u>"

If we accept this point of view, then true equality exists only when cooperative patrons pay for the actual cost, to the cooperative, of providing the services. In terms of this interpretation, equal treatment is synonymous with fair treatment.

Marketing Charges Often Deviate

Pursuing this line of reasoning, what are some possible modifications to a policy of strict equal per-unit charges or margins? Consider the following selected example of services provided by marketing cooperatives and what some cooperatives have done to make their charges more accurately reflect the cost of providing these services.

Harvesting Charges

Harvesting is a service provided by many marketing cooperatives. An executive of a leading fruit marketing cooperative writes that "The assessment of proper picking costs has developed along rather scientific lines. While this problem is not related to size, that is, volume, it does relate to those factors influencing the man-hours required per unit of picking (the cost of providing the service).

"The associations all use a picking schedule. The rate per box paid the picker and charged to the grower depends on the size of the tree, the size of the fruit, and the quantity of fruit per tree. Under this plan the picker is able to make substantially the same hourly rate under various conditions of picking. These cost variations are passed on to the grower."

Transportation Charges

Transportation is another service provided by marketing cooperatives. A large number of egg marketing cooperatives have adopted varying rates for hauling similar to the following described program: "A sliding scale of trucking charges has been put into operation, dependent on the number of cases collected at each farm. This can be justified on the basis of time consumed per case loaded at one stop.

"This move has not been made with the intent to penalize the small producer. Rather, it tends to reflect more accurately the cost of doing business with the various sizes of producers. It helps us to hold our own fair share of business."

Processing Charges

Washing, or otherwise processing, the product handled for their members is another service provided by many marketing cooperatives. Quoting again from

the experience of a number of fruit marketing cooperatives, we have the following report: "There is no question but that the cost per unit is greater with the small grower than with the large. These added costs begin to accumulate as the fruit is picked up from the farm, received and run through the machines, and finally as the records are completed in the office.

To date, only a few of our cooperatives have adopted means of equalizing these costs. Even in such cases, the approach has been arbitrary rather than exact. This has been done by making a fixed charge on each lot of fruit handled through the washer. In the houses using this procedure, there is a flat charge per washer lot regardless of the number of boxes run. This charge is presumed to cover some of the related fixed charges. Obviously, this flat charge is more per box on a small lot than on a large lot."

Inspection Charges

Inspection is still another cost item incurred by many marketing cooperatives. One cooperative executive reported that an analysis of his inspection cost revealed the cooperative "was spending inspection money at the rate of $24 per ton on 80 percent of the number of deliveries, and at the rate of $2 per ton on 20 percent of the number of deliveries. In order to equalize inspection costs, we instituted an inspection charge of $1.80 per delivery (regardless of size of delivery).

"While this does not completely pay for the entire cost of inspection and bookkeeping, it does help as an equalizing factor. This charge has been quite favorably received by our membership. It has increased the size of deliveries by smaller growers. Instead of throwing five bags in the back of the family car and making several deliveries, they are now tending to arrange to make one delivery where formerly they made two to five."

The writer of the above points out that the new policy "has done two things of considerable importance:

"1. It has impressed upon the people making both the large and small deliveries that one cannot expect to ride on the back of the other, and

"2. Indirectly, it has jelled in the minds of most large producers the thought that they do need the tonnage produced by a multitude of small growers in

order to give satisfactory volume to handle in a fairly well stabilized market."

Receiving Charges

Receiving is one cost faced by all marketing cooperatives which take physical possession of the product. In some cases, association managers feel there are so many variable factors to consider that it is not practical to make any distinction between large and small producers. In other cases there seem to be wide enough differences to merit attention.

Commenting on the number of variables which might be involved, the manager of a grain marketing association points out, "There are many factors which would cause variations in receiving costs. For example, a patron with 300 bushels of wheat delivered in one truckload probably would have a lower per-unit (receiving) cost than one with 2,000 bushels of wheat delivered in 50-bushel loads. The type of tailgate in the truck, for example, might have a bearing on costs of receiving grain."

To date this association has not considered variations in receiving costs sufficiently significant to incorporate into producer returns.

In addition to tangible, measurable differences in per-unit costs associated with marketing farm products, one writer listed an item which he called "marketability." According to this man, "At times in an area of particularly keen competition for desirable supplies and members, a purely competitive differential is provided and usually referred to as marketability."

Supply Margins Also Vary

Adjusting per-unit margins for goods or services bought through supply cooperatives poses both problems and opportunities. These are considered under three headings:

Improving Plant Efficiency

Improving plant efficiency as measured in per-unit operating costs is often possible because such costs bear an inverse

relationship to volume, plant capacity, and rate of plant use. One way in which plant efficiency may be improved is by encouraging purchases during slack seasons, as a means of smoothing out the flow of goods over the 12-month period.

One cooperative executive says that "We can get a substantially lower price on tires, which we pass on to the local co-ops both in original price and in refunds, if we place an order for part of our summer tire needs in January. This permits the factory to schedule production more economically.

"A similar situation, but more complicated, exists in the preseason dating and shipping of fertilizer. We allow a substantial discount, per ton, on orders placed and shipped in October. The discount reduces each month until about March, when it ceases. The purpose of this policy is much more than purely financial. It is just physically impossible to produce and ship our fertilizer requirements during a 6-week period in the spring when farmers want it. This is not equal treatment for a dollar's worth of fertilizer purchased, but it is in my opinion fair and just."

Achieving Economies of Scale

Achieving economies of scale in supply cooperatives is possible because of the customary lower per-unit cost associated with large-volume operations.

A large federated supply cooperative reports: "Up to about 5 or 6 years ago we maintained a one-price policy on commodities whether the member purchased 1 unit or 300 units in a given shipment. We at that time recognized that perhaps our previous approach was fair in one sense, yet in another we were not reflecting costs accurately to members in their actual category of usage. A study of costs of local services with varying amounts of usage showed that not only were local costs greater in serving the smaller user (per unit of commodity), but our classification process and patronage records were also more costly to maintain than was the case with the larger user.

"To meet this problem, we have developed a program which we call 'Service Cost Adjustments' in which we attempt to reflect as accurately as possible economies which result where larger volume is taken."

Other cooperatives balance price with cost.

Looking at economies of scale from a slightly different perspective, consider the following: "If we deliver 100 gallons to a member, the cost is much the same as if we had delivered 500 gallons. While there would be some additional loading time, some additional unloading time, and a slight increase in the expense of hauling, these increases would be minor. Therefore we may correctly assume that all persons who make available larger storage and who order larger quantities are entitled to some price consideration."

Finding a Workable Plan

Finding a workable plan constitutes the third factor associated with efforts to classify margins by volume. In thinking about this factor, we are confronted with three questions: "How shall we define 'large volume'?" "Where should price concessions start?" and, perhaps equally important, "Where should price concessions stop?"

An excellent discussion of this is contained in a letter written Farmer Cooperative Service by the manager of a local petroleum cooperative. He indicated that the attempt to reconcile equal treatment with fair treatment was relatively new to his organization. In his letter he gave examples of some of the special problems he and his board have wrestled with:

"Suppose a farmer is farming quite a large-scale operation and expects a special discount due to his volume. He refuses to add to his on-the-farm storage, however, and expects our organization to qualify him as a volume purchaser. The deliveries he requires during the year are numerous, so we cannot reduce our delivery expense. The Board has decided that such a farmer is not a large-volume user, and therefore no concession will be made. We have lost some customers due to this decision.

"Another member has agreed to accept large quantity fills. He has authorized a 'keep full' type of operation, which permits us to make deliveries more economically and at our convenience. We consider this farmer a large-scale operator.

"Following general trade practices in our area, we will discount 1 cent per gallon if (1) customer uses in excess of 5,000 gallons per year, (2) customer provides large storage units, and (3) customer gives us a 'keep full' authorization.

"But the practice has caused us new headaches. We have customers now who ask for concessions where their combined volume of two or more types of fuel exceeds the 5,000-gallon requirement. We are still trying to solve this one."

The matter of determining at what point price concessions are to start and beyond what point they are to stop is one associated largely with the nature of accounting costs. It is obvious that below a certain volume and saving, the cost of keeping special records may equal or even exceed the amount of the savings. At the upper end of the scale of volume purchases there comes a point at which the saving per unit levels out and for all practical purposes becomes constant.

Despite the emphasis on efficiency, however, evident in all the comments on the topic of fair treatment is a feeling of caution. Cooperatives need both large and small members. Two statements summarize this feeling well.

A supply cooperative executive states: "In our organization we have a general philosophy that pricing to patrons should reflect the cost of servicing patrons.

"In order to keep our unit costs as low as possible, we must have the larger users' patronage. We think this is in the interest of the smaller patrons, because without the larger patrons our unit costs would obviously be higher."

The manager of a large marketing cooperative is equally explicit: "I feel that the wisest course is a very moderate approach to applying costs where they belong in order to give proper consideration to the increased volume that the small or distant producer brings. I always feel that if an adjustment needs to be made, it is better to make it a modest one and then take a good look at it before going to an extreme."

Dangers in Reconciling Costs With Charges

The establishment of scales of operating margins or marketing charges involves certain obvious pitfalls.

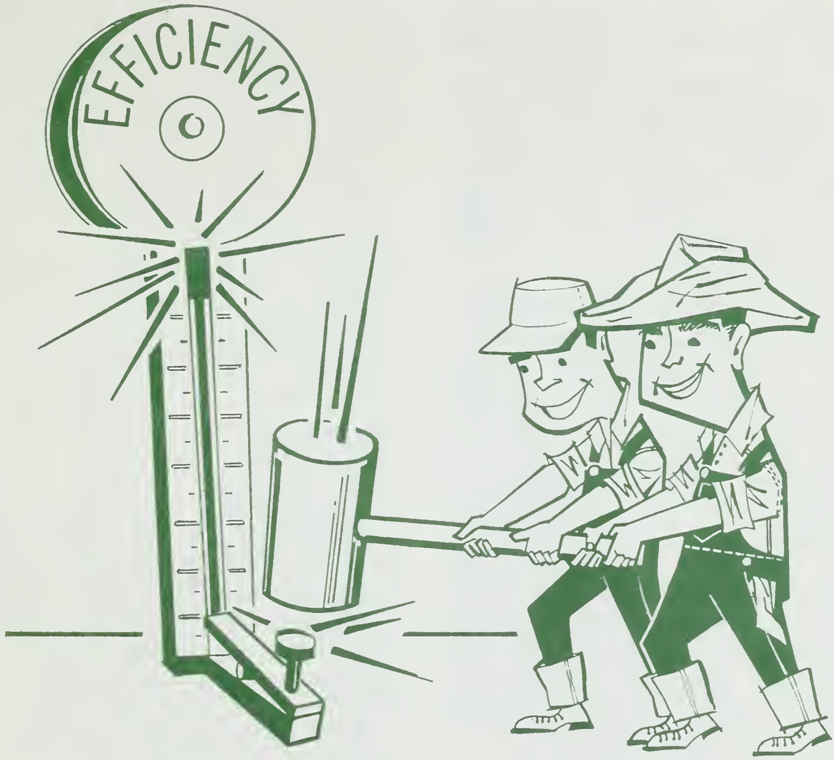
Expediency

Cooperatives which base charges on expediency--where the policy is, in effect, to have no policy--may expect trouble.

One cooperative manager who discussed this matter with us reports that "In our distribution of certain farm supplies we have an inconsistent, unjustified plan. We give discounts to some, deny them to others, meet the price competition where necessary, and create for ourselves a very unsatisfactory relationship with everyone concerned. If we adhere to a 'flat across the board' price, we lose business to competitors. If we meet price competition we are out of line in equitable treatment of our members. I am very unhappy with the setup and I have not yet figured out how to change it."

Unwarranted Price Concessions

A second pitfall in attempting to establish fair scales of operating margins or marketing charges occurs where supposedly large customers are granted volume price adjustments without provision for periodic review to make sure the adjustments are warranted.



Small and large members need each other.

A large supply cooperative at one time followed a policy of granting certain customers price concessions because of their anticipated larger volumes of business. Study of its patronage records brought to light some interesting facts.

One such (supposed) large user, during the year under study, purchased less than $700 worth of farm supplies. During that same year over 100 nonfavored members of the association purchased (at higher prices) an average, per member, of over $2,400 worth of farm supplies from the cooperative.

Officials were properly concerned about the obvious weakness of their pricing program. In too many instances, one executive pointed out, the favored classification was granted just to get an order--often on potential rather than actual patronage. There was no attempt at followup control. The program in some cases actually encouraged patrons to ask for special favors.

Above all, the program was found to be a stumbling block to good member and public relations. It tended to weaken the morale of cooperative personnel and put immediate sales above the long run welfare of the cooperative.

To correct the weakness of the program the cooperative in question established a new program. Prices are keyed to actual cost of providing the service. In addition, the cooperative publicizes and allows certain wholesale quantity discounts at the close of each year, based on annual dollar volume of purchases by patrons. The new program allows discounts only after they have been earned.

The cooperative feels that the new program is fair to everybody, can be defended, and is simple to administer. All patrons know about the discount due them at all times.

Faulty Communication

The advantage of having members fully informed about scales of prices, and the basis for such scales, is pointed up by the following comment: "Late last summer we put in a series of margins for various size shippers. The scale was arrived at after considerable study. It turned out to be a 'bombshell.' The theory was right but the mechanics were wrong. The smaller producers complained because they received less money for their product. This was in spite of the fact that the return was based on the actual cost of handling. Large producers were unhappy because they thought we were penalizing the smaller members in order to pay the larger members more."

In reviewing the above problem and why it arose, it seemed apparent that members had not been properly informed about the basis for price differentials. Although a notice was sent out to members, it merely stated that a cost survey proved conclusively that it cost the association more to handle small shipments than it did to handle large shipments.

Another possible reason for the disconcerting result in the above case was that certain terms used in accounting for margin differentials may have created a bad psychological impression. For example, the price used as the base was actually the middle price. There were three different prices under the so-called base price, and four over it. Perhaps it would have been better psychologically to call the bottom price the base price.

Some Recommendations

Careful review of the many thoughtful and thought-provoking comments referred to in this brief discussion of the whole problem of equal versus fair treatment for large and small members in the same cooperative suggests the following recommendations:

1. Cooperative management should analyze its cost-volume-service relationships periodically, should know what its costs are, and should be everlastingly alert to what the competition is doing.

2. Effective cooperative management will not wait to be forced into following the leadership of its competitors. If a cost adjustment is fair the day after a competitor starts it, the chances are pretty good that it was fair to member-patrons the day before.

3. When considering how to reflect costs more accurately, cooperative management should keep in mind the additional volume of business brought in by small or distant members. Many cooperative managers point out that the large or advantageously located members and the small or distant members need each other.

4. Where a cooperative does install a service cost adjustment program, management must be sure that members fully understand the situation and the reason for the adjustment.

5. Under all circumstances the cooperative must be sure, before it moves in the direction of service cost adjustments, that it is prepared to defend its position.

Other Publications Available

The Story of Farmer's Cooperatives, Educational Circular 1. By R.H. Elsworth.

Sizing Up Your Cooperative, Educational Circular 11.

Exploring Communication Processes in a Farmer Cooperative--A Case Study, General Report 97. By James H. Copp and Irwin W. Rust.

When Members Talk, Reprint 200. By Oscar R. LeBeau and J.C. Eiland.

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